

1996 FARM BILL

Implications for Ohio Grain Producers

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The new farm bill has released grain producers from many of the shackles of government control. Planting decisions can now be made for the market, as perceived by the producer, rather than government program rules. Uncle Sam will have little to no role in planting and marketing decisions. The most important feature is that government **payments are decoupled from current production**. Payments will be based on past production decisions, not on what or how much of a crop a producer plants or doesn't plant in the current year. In addition acreage set-asides will no longer be required or permitted. The only requirements are that producers sign up, meet conservation compliance rules, and don't plant fruits and/or vegetables on contract acreage.

Grain producers will have complete control over the crop mix. For whatever reason (maximization of short term profit, landlord preferences, ecological concerns, livestock needs, etc.) a grain producer can choose to plant any combination of crops, including 0 or 100 percent in a single crop such as corn if that is desirable for some reason. This flexibility will permit some "mono-culture" producers, encouraged by the economics of the old farm bill, to return to a more ecologically sound crop rotation that could reduce fertilizer and pesticide use. Improved crop rotations may permit some producers with erodible soils to meet conservation compliance goals without installing more expensive measures.

With more freedom comes more risk. Some have, tongue-in-cheek, restated "**freedom to farm**" as "**freedom to fail**," but there is measure of truth here. The old farm bill protected a portion of the crop (non-flex acreage at program yield) at "target prices", \$2.75 for corn and 4\$ for wheat. In the event market price fell below target price "deficiency" payment were used to restore income. **NO MORE**. Under the new "**Production Flexibility Contract**" price and income protection fall to the "loan rate." Loan rates for corn and wheat are capped at '95 rates, \$1.89 and \$2.48 respectively. The soybean rate can vary between \$4.92 and \$5.26 during the 7-year program. Deciding not to participate in the program excludes a producer from the associated "transition payments" and exposes the farm business to less than "loan rate" income, in the event market prices fall below loan rates.

Under the old program the name of the game was "farm the program." **Risk management is the name of the new game**. The economic environment created by the new farm bill brings a new sense of importance to managing production, marketing, and financial risks faced by grain producers. In some sense the old program had some production risk abatement built in. Catastrophic crop insurance (CAT) was mandatory and deficiency payment were payable regardless of realized yield. The new program does not require CAT or any other crop insurance, although producers must sign a waiver if they decide not to carry crop insurance, leaving **production risk wide open**. Some or all of this production risk can be abated by purchasing needed levels of crop insurance, using "yield insurance futures and options, and/or with crop diversification and/or rotation. **Price (i.e. market) variability is likely to increase** in the new economic climate. Knowing and understanding when and how to properly use futures, options, and other contracts to fix prices, put floors under prices, and to manage "basis risk" takes on a new sense of importance. "Big Uncle" is getting out of the business of managing prices. Producers must take a more active role. Inappropriate price management and/or unmanaged price instability will likely put some producers out of business. Financial risk is created by debt capital. Unmanaged exposure to increased price and market risk under the new farm bill will create a **need for many producers to reduce financial risk**. The only way to reduce financial risk is to reduce debt. The new farm bill creates a more risky economic climate for grain producers. Economic survival in an unmanaged riskier environment requires a lower level of debt.